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AN OVERVIEW OF RECENT U.S. “INTERNATIONAL TAX LAW” CHANGES.

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The Hiring Incentives to Restore Employment (“HIRE”) Act

- The HIRE Act was signed into law on March 18, 2010.
- The Hire Act has implemented certain new withholding tax and information reporting laws to the Internal Revenue Code (“Code”), most commonly referred to as the Foreign Account Tax Compliance Act (“FATCA”).

New Code Section (“§”) 1471 through §1474

- The HIRE Act added Code §§1471 through 1474. These Code Sections generally require that, with respect to any U.S. accounts, a withholding agent must withhold 30% of the amount of any withholdable payment to a foreign financial institution (an “FFI”) if such institution does not comply with certain reporting requirements.
- Subject to certain grandfathering rules, Code §§1471-1474 are generally effective for payments made after December 31, 2012.
- Under new Code §1471, an FFI could comply by entering into an agreement with the IRS pursuant to which it would obtain information on each holder of each account that it maintains, necessary to identify which are U.S. accounts, follow verification and due diligence procedures, respond to information requests, and report annually on any such account, including (but not limited to) the name, address, and TIN of each U.S. person account holder, the account number, balance or value, and gross receipts or withdrawals or payments.
- An FFI must also agree to impose withholding on any pass-through payment to a recalcitrant account holder or a nonparticipating FFI and, if any foreign law prevents its compliance, to try to obtain from each U.S. account holder a waiver of that law and to close the account if it is unable to do so.
- The IRS is authorized to terminate any agreement upon a determination of non-compliance.
- A special election is also available for an FFI to be withheld upon rather than to withhold.

New Code Section (“§”) 1471 through §1474 (cont.)

- New Code §1473 provides a number of definitional terms necessary for the administration of these rules, including but not limited to:
 - Foreign financial institution: any financial institution which is not a U.S. person or such institution organized under the laws of a U.S. possession.
 - Financial institution: any entity that accepts deposits in the ordinary course of a banking or similar business, as a substantial portion of its business, holds financial assets for others, or is primarily engaged (or holds itself out as such) in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest therein.
 - United States owned foreign entity: any foreign entity which has one or more substantial U.S. owners.
 - United States account: any financial account held by one or more specified U.S. persons or U.S. owned foreign entities, but not depository accounts held by a natural person and maintained by the same FFI, if the aggregate value thereof does not exceed \$50,000. Also excluded is any financial account held by another participating FFI or an account holder that would be subject to duplicative reporting requirements.
 - Financial account: any depository and any custodial account maintained by any financial institution and any equity or debt interest in such institution (other than publicly traded interests).
 - Withholdable payment: any U.S.-sourced payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, and any gross proceeds from the sale or disposition of any property which can produce U.S.-sourced interest or dividends, but not income taken into account under Code §871(b)(1) or Code §882(a)(1) for the taxable year.
 - Withholding agent: all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of any withholdable payment.

New Code Section (“§”) 1471 through §1474 (cont.)

- Three choices for an FFI:
 - Continue to invest in the U.S., enter into an agreement with the IRS (when the relevant Form is available) and perform the necessary diligence, reporting and withholding obligations under such agreement;
 - Avoid having any U.S. customers; or
 - Stop holding U.S. source generating investments.

Repeal of Certain Exceptions to Registered Bond Requirements

- Code §871(h)(2)(A) allowed certain non-registered debt obligations (generally foreign targeted debt obligations) to qualify for the Portfolio Interest Exemption.
- Code §871(h)(2)(A) has been repealed and certain related conforming changes were made.
- This change is effective for debt obligations issued after March 18, 2012.

Disclosure of Information with Respect to Foreign Financial Assets: New Code §6038D

- Code §6038D requires individual taxpayers with an interest in a “specified foreign financial asset” during the taxable year to attach a disclosure statement to their U.S. income tax return for any year in which the aggregate value of all such assets exceeds \$50,000.
- For purposes of Code §6038D, the term “specified foreign financial asset” means:
 - any financial account maintained by a foreign financial institution, and
 - any of the following assets which are not held in an account maintained by a financial institution:
 - (A) any stock or security issued by a person other than a United States person,
 - (B) any financial instrument or contract held for investment that has an issuer or counterparty which is other than a United States person, and
 - (C) any interest in a foreign entity.
- Code §6038D(c) requires information that is similar (but not identical) to the information disclosed on a Form TD F 90-22.1 (e.g., account and institution data and maximum value).

Disclosure of Information with Respect to Foreign Financial Assets: New Code §6038D (cont.)

- Code §6038D provides the IRS with regulatory authority to issue guidance necessary and appropriate to carry out the purpose of §6038D, including guidance on appropriate exceptions (e.g., duplicate filings).
- Individuals who fail to make the required disclosures are subject to a penalty of \$10,000 for the taxable year. Additional penalties (up to a maximum of \$50,000) could apply if the IRS notifies an individual of the failure to disclose and such failure continues. No penalty is imposed where such failure to disclose is due to reasonable cause and not willful neglect.
- If the IRS determines that an individual has an interest in one or more “specified foreign financial assets” and such individual does not provide enough information to enable the IRS to determine the aggregate value thereof, §6038D(e) provides that the aggregate value of such assets will be presumed to exceed \$50,000 for purposes of assessing the penalty.

Disclosure of Information with Respect to Foreign Financial Assets: New Code §6038D (cont.)

- §6038D(f) also gives the IRS the power to apply the reporting requirement to any domestic entity that is formed or availed of to avoid the individual reporting requirement.
- §6038D is effective for taxable years beginning after March 18, 2010 (the date of enactment).

Penalties for Underpayments Attributable to Undisclosed Foreign Financial Assets: New §6662(b)(7) and §6662(j)

- Code §6662(j) imposes a 40% penalty on any understatement attributable to an undisclosed foreign financial asset.
- The term “undisclosed foreign financial asset” includes all assets subject to certain information reporting requirements (e.g., under Code §§6038, 6038B, 6038D, 6046A or 6048) for which the required information was not provided by the taxpayer as required under the applicable reporting provisions.
- These provisions are effective for taxable years beginning after March 18, 2010 (the date of enactment).

Modification of Statute of Limitations for Significant Omission in Connection with Foreign Assets: Code §6501(c)(8) and §6501(e)(1)

- Code §6501(e)(1) provides for a six (6) year limitations period for assessment of tax on understatements of income attributable to foreign financial assets where : (1) there is an omission of gross income in excess of \$5,000; and (2) the omitted gross income is attributable to an asset with respect to which information reports are required under Code §6038D (applied without regard to the dollar threshold, the statutory exception for nonresident aliens and any exceptions provided by regulation).
- Also, Code §6501(c)(8) (which suspends the limitations period for assessment to the date which is 3 years after the date on which the IRS is furnished the information required to be reported) was amended to apply where a taxpayer fails to provide timely information returns required with respect to passive foreign investment corporations and reporting of foreign financial assets.
- This is effective for returns filed after March 18, 2010 (the date of enactment) as well as for any other return for which the assessment period specified in Code §6501 has not yet expired as of March 18, 2010.

Reporting of Activities with Respect to Passive Foreign Investment Companies: New §1298(f)

- Code §1298(f) requires that, unless otherwise provided by the IRS, each U.S. person who is a shareholder of a passive foreign investment company (a “PFIC”) must file an annual information return containing such information as the IRS may require.
- This is effective on March 18, 2010 (the date of enactment).
- In Notice 2010-34, 2010-17 IRB 612, the IRS announced that it is developing further guidance regarding the reporting obligations under §1298(f). Until such guidance is released, the IRS has stated that:
 - persons that were required to file Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or a Qualified Electing Fund, prior to the enactment of Code §1298(f) must continue to file Form 8621 as provided in the Instructions to such form (e.g., upon disposition of stock of a PFIC, or with respect to a qualified electing fund under §1293); and
 - shareholders of a PFIC that were not otherwise required to file Form 8621 annually prior to March 18, 2010, will not be required to file an annual report as a result of the addition of §1298(f) for taxable years beginning before March 18, 2010.

Clarifications with Respect to Foreign Trusts Which Are Treated as Having a United States Beneficiary: Revised §679

- Code §679 treats a U.S. person transferor of property to a foreign trust having a U.S. beneficiary as the owner of the related portion of such trust. The HIRE Act clarifies in several respects the determination whether a foreign trust has a U.S. beneficiary for this purpose.
 - Code §679(c)(1) treats an amount as accumulated for the benefit of a U.S. person even if the U.S. person's interest in the trust is contingent on a future event.
 - Code §679(c)(4) provides that if any person has the discretion (by the trust agreement, power of appointment, or otherwise) to make a distribution from the trust to, or for the benefit of, any person, the trust is treated as having a U.S. beneficiary unless:
 - the terms of the trust specifically identify the class of persons to whom such distributions may be made, and
 - none of those persons is a U.S. person during the taxable year.
 - Code §679(c)(5) provides that any agreement or understanding (whether written, oral, or otherwise) that may result in the income or corpus of the trust being paid or accumulated to or for the benefit of a U.S. person will be treated as a term of the trust if any U.S. person who directly or indirectly transfers property to the trust is directly or indirectly involved in any such agreement or understanding.
 - Code §679(d) provides that if a U.S. person directly or indirectly transfers property to a foreign trust (other than certain deferred compensation trusts and charitable trusts), the trust is presumed to have a U.S. beneficiary for purposes of §679; however, this presumption does not apply if such U.S. person:
 - submits such information as the IRS may require; and
 - demonstrates to the IRS's satisfaction that no trust income or corpus may be paid or accumulated to or for the benefit of a U.S. person.
- These provisions are effective on March 18, 2010 (the date of enactment).

Uncompensated Use of Trust Property: Revised §643(i) and New §679(c)(6)

- Code §643(i)(1) treats a loan of cash or marketable securities by a foreign trust to a grantor, beneficiary, or related person who is a U.S. person as a distribution for non-grantor trust purposes.
- Under Code §643(i)(1) and 643(i)(2)(E), the same distribution treatment applies to the use of any property of a foreign trust by such a U.S. person to the extent the trust is paid less than fair market value compensation for such use within a reasonable period of time.
- In addition, for purposes of determining whether a foreign trust has a U.S. beneficiary under §679, §679(c)(6) treats a loan of cash or marketable securities or use of any other trust property by a U.S. person as payment from the trust to the U.S. person to the extent such person pays less than market interest on a loan or less than fair market value for the use of trust property within a reasonable period of time.
- These provisions are effective for loans made and uses of property after March 18, 2010 (the date of the enactment).

Reporting Requirement of United States Owners of Foreign Trusts: Amended §6048(b)(1)

- Code §6048(b) now requires a U.S. person that is treated as an owner of any portion of a foreign trust under the grantor trust provisions to provide information as may be required with respect to the trust (in addition to the preexisting obligation of ensuring that the trust complies with its reporting obligations).
- This is effective for tax years beginning after March 18, 2010.

Minimum Penalty with Respect to Failure to Report on Certain Foreign Trusts: Amended §6677(a)

- The Code provides a penalty for failure to report information as to certain foreign trusts if a U.S. person is a creator or transferor to such trust, an owner of such trust under the grantor trust rules, or a distributee of such a trust. Generally speaking, the penalty is 35% of the gross reportable amount plus additional amounts for failure to report every 30 days after the first 90 days.
- Under the HIRE Act, §6677(a) has been amended so as to increase the minimum penalty to the greater of \$10,000 or the penalty under preexisting law.
- This is effective for returns required to be filed after December 31, 2009.

Substitute Dividends and Dividend Equivalent Payments Received by Foreign Persons Treated as Dividends: New §871(l)

- New Code §871(l) treats a dividend equivalent as U.S. source income for purposes the 30% “flat tax” on fixed or determinable annual or periodical income of nonresident alien individuals and foreign corporations.
- The term “dividend equivalent” means the following:
 - any substitute payment made pursuant to a securities lending or sale-repurchase transaction that (directly or indirectly) is contingent upon, or determined by reference to, a dividend payment from U.S. sources;
 - any payment made pursuant to a specified notional principal contract that (directly or indirectly) is contingent upon, or determined by reference to, a dividend payment from U.S. sources; and
 - any other payment determined by the IRS to be substantially similar either of the foregoing.
- A “specified notional principal contract” is a notional principal contract that has any of the following five characteristics:
 - in connection with entering into the contract, any contract party entitled to receive a payment (a “long party”) transfers the underlying security to any contract party not so entitled (a “short party”);
 - in connection with the termination of the contract, any short party transfers the underlying security to any long party;
 - the underlying security on which the dividend is paid is not readily tradable on an established securities market;
 - in connection with entering into the contract, any short party posts the underlying security as collateral with any long party; or

Substitute Dividends and Dividend Equivalent Payments Received by Foreign Persons Treated as Dividends: New §871(l) (cont.)

- the IRS identifies the contract as a specified notional principal contract.
- In addition, for any payment made more than two years after the March 18, 2010 date of enactment of Code §871(l), a specified notional principal contract includes any notional principal contract unless the IRS determines it is a type of contract that does not have the potential for tax avoidance.
- The payments that are treated as U.S. source dividends under Code §871(l) are the gross amounts that are used in computing any net amounts transferred to or from the taxpayer.
- If there is a chain of taxable dividend equivalents, the IRS is authorized to reduce the tax to the extent the taxpayer establishes that the tax has been paid or is not otherwise due.
- For purposes of the withholding taxes and Code §§1471-1474 taxes, each party to the arrangement is treated as having control of the payment.
- This is effective for payments made on or after September 14, 2010.

Delay in Application of Worldwide Allocation of Interest: Amended §864(f)

- The HIRE Act delays the application of the worldwide allocation of interest expense for three (3) years until tax years beginning after December 31, 2020, with the required dates for making the worldwide affiliated group election and the financial institution group election changed accordingly.

Patient Protection and Affordable Care Act, with Amendments of the Health Care and Education Reconciliation Act of 2010

- The Economic Substance Doctrine is now codified under Code §7701(o).
- Revised Code §6662 provides a new penalty for an understatement attributable to any disallowance of claimed tax benefits by reason of a transaction lacking economic substance, as defined in new §7701(o), or failing to meet the requirements of any similar rule of law.
 - Pursuant to Code §6662(b)(6) and Code §6662(i), the penalty rate is 20% (increased to 40% if the taxpayer does not adequately disclose the relevant facts affecting the tax treatment in the return or a statement attached to the return).
 - Code §6662(i) also provides that an amended return or supplement to a return is not taken into account if filed after the taxpayer has been contacted for audit or such other date as is specified by the IRS.
 - Pursuant to Code §6664(c)(2), no exceptions (including the reasonable cause rules) to the penalty are available .
 - Also, §6676(c) exempts transactions lacking economic substance from qualifying as having a reasonable basis with respect to the 20% penalty for excessive erroneous claims for refunds.
- These changes are effective for transactions entered into after the date of enactment.